Supreme Court, U.S.
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No.

In The

Supreme Court of the United States

October Term, 1997

ERIC WYNN,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR WRIT OF CERTIORARI

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Lutz Appellate Services, Inc.

60 pp

QUESTIONS PRESENTED

1. Whether in a Rule 10b-5 criminal stock manipulation prosecution the United States must prove a misrepresentation or non-disclosure in connection with an identifiable purchase or sale of a security?

2. Whether this Court's opinion in *United States v. O'Hagan*, __ U.S. __, 117 S. Ct. 2199 (1997), holds that the deception at issue in a Rule 10b-5 criminal prosecution must coincide with a securities transaction under either the misappropriation theory or stock manipulation theory?

3. Whether the Third Circuit Court of Appeals opinion in *United States v. Wynn*, 134 F.3d 542 (3rd Cir. 1998), creates a clear conflict with the Second Circuit Court of Appeals opinions in *United States v. Persky*, 520 F.2d 283, 288 (2nd Cir. 1975) and *United States v. Russo*, 74 F.3d 1383 (2nd Cir. 1996), wherein the Second Circuit ruled that reliance is an element of a Rule 10b-5 stock manipulation prosecution?

4. Whether the unit of prosecution in a Rule 10b-5 criminal prosecution must be limited to the misrepresentation and the coinciding securities transaction?

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APPENDIX

Appendix A — Opinion Of The United States Court Of Appeals For The Third Circuit Filed January 21, 1998	1a
Appendix B — Statutory Rule And Constitutional Provision Involved	20a

Petitioner prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit entered in this proceeding on January 21, 1998.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit is entitled *United States v. Eric Wynn*, 134 F.3d 542 (3rd Cir. 1998).

STATEMENT OF JURISDICTION

The jurisdiction of the Supreme Court to review the final judgment of the United States Court of Appeals for the Third Circuit is based on 28 U.S.C.A. § 1254(1).

STATUTORY RULE AND CONSTITUTIONAL PROVISIONS INVOLVED

Petitioner seeks review of issues of law arising under 17 C.F.R. 240, 10b-5, and the Sixth Amendment to the United States Constitution. (App. B, *infra*).

STATEMENT OF THE CASE

I. INTRODUCTION

A. The Legal Issue

The instant Petition for Certiorari presents this Court with a question of great public importance and juridical significance. Specifically, this Court must definitively rule whether "reliance is an element of the *crime* of stock manipulation, proof of which is essential to conviction". *United States v. Wynn*, 134 F.3d 542, 549 (3rd Cir. 1998). The Third Circuit ruled in *Wynn* that "no such statutory requirement exists". *Id.* Prior to the decision in *Wynn*, it was understood that proof of either a misrepresentation or non-disclosure in connection with an identifiable purchase or sale of a

security is an indispensable evidentiary aspect of a stock manipulation prosecution. The United States assumed its position herein because it lacked proof of any misrepresentation uttered to any party or any actionable non-disclosure.

The Third Circuit reached a clearly erroneous finding because of its misinterpretation of this Court's opinion in *United States v. O'Hagan*, __ U.S. __, 117 S. Ct. 2199 (1997). In *O'Hagan*, a majority of this Court ruled that § 10(b) "does not *confine* its coverage to deception of a purchaser or seller of securities". That majority espoused the above-quoted principle as the foundation for affirming the vitality of the misappropriation theory of Rule 10b-5 criminal liability. It did not in any fashion disparage or delete deception in connection with an identifiable purchase or sale of a security as an element of stock manipulation.

Simply put, expression of the misappropriation theory as not requiring deception of a purchaser/seller did not exclude the need for such deception as an element of stock manipulation. Stated somewhat differently, "expressio unius est [non] exclusio alterius". As is discussed below, the deceived purchaser/seller element of a stock manipulation prosecution is akin to the deceived beneficiary of fiduciary trust element of a misappropriation prosecution.

The misappropriation theory was described in elemental form in *SEC v. Clark*, 915 F.2d 439, 443 (9th Cir. 1990). The misappropriation theory authorizes the criminal conviction of a person who: (1) misappropriates material non-public information; (2) by breaching a duty arising out of trust and confidence; (3) uses that information in a securities transaction; and (4) regardless of whether he owed any duties to the shareholders of the traded stock. As was previously noted, the ruling in *O'Hagan* ratifying the above-described misappropriation theory was misinterpreted by the Court in *Wynn* as support for a finding that "reliance on the deceptive practice by an identifiable victim participating in a securities transaction is not required for conviction in [a] stock manipulation case". *United States v. Wynn, supra* at 551.

The error of the Court in *Wynn* is manifest from any perceptive reading of the full opinion in *O'Hagan*. This Court in *O'Hagan* defined "just what the word (manipulation) means in § 10(b)". 117 S. Ct. *supra* at 2216. The Court stated that "absent misrepresentation or nondisclosure, an act cannot be indicted as manipulative." *Id. See Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 7-8 (1985). Succinctly stated, the failing of the *Wynn* Court is in its inability to differentiate between misappropriation and manipulation for Rule 10b-5 liability purposes. Proof of misrepresentation (deception) in a manipulation case requires identification of a coinciding purchase or sale of a security by the deceived person. Similarly, proof of a misappropriation requires identification of a defrauded person who entrusted the defendant with non-public information and a coinciding purchase or sale of a security by the defendant.

The *Wynn* Court's faulty premise stems from its view that affirmation of the misappropriation theory as being within the scope of Rule 10b-5 in some fashion diminished the indispensable proof requirements relative to an alleged stock manipulation. The misappropriation theory and manipulation have different elements but are symmetrical. The misappropriation theory involves deception in the context of breach of a fiduciary duty as opposed to deception of a purchaser or seller of securities. The symmetry which the *Wynn* Court did not grasp is that both theories of Rule 10b-5 liability require deception of an identifiable and reliant victim.

It bears repeating that the misappropriation theory requires deception of an identifiable person or entity who relied on the defendant to maintain trust and confidence. The manipulation theory requires deception of a identifiable purchaser or seller of securities who relied on a misrepresentation or was victimized by a non-disclosure. In this context, acknowledgment that misappropriation of non-public information in breach of a fiduciary duty is within Rule 10b-5 does not require nor may it permissibly effect any modification of the reliance element of a stock

manipulation. Indeed, we iterate that misappropriation has the same critical elements of manipulation, viz. deception of an identifiable reliant victim. But for those elements, the misappropriation and manipulation theories would be outside Rule 10b-5. And, but for the United States' inability to produce evidence of a misrepresentation, it would not have sought to bend and refract established law.

B. The Case At Issue

Petitioner was indicted and charged with conspiracy; securities fraud, and wire fraud. According to the facts as alleged in the indictment, petitioner violated Rule 10b-5 by effecting domination and control of penny stocks issued by various companies and thereafter providing inducements to brokers and/or market makers to trade the stocks as instructed in the initial public-offerings and after-market. In this context, the United States in the indictment characterized petitioner's actions as a manipulation

> designed to raise, lower, maintain, and control the prices of various securities and to create a greater demand for these securities, thereby insuring that they could profit on trading of these securities.

In support of this concept, the indictment alleged that domination and control of penny stocks and provision of inducements to brokers and/or market makers were improper and/or illegal acts.

At trial, the district court ruled that neither domination and control nor payment of inducements was proscribed in 1988. Indeed, the United States' own expert witnesses conceded this issue. Therefore, it became manifest that the grand jury was misinstructed by the United States as to the propriety of the so-called means undertaken by petitioner. The district court's ruling should properly have resulted in dismissal of the indictment. However, the United States modified its theory and urged the petit jury to convict on the ground that petitioner utilized recognized and lawful market

strategies with the intent to effect a fraud. The district court permitted this form of constructive amendment of the indictment and the fatally infirm prosecution proceeded to an unjust and wrongful verdict.

As was detailed in Part A, *supra*, the most significant and egregious harm to petitioner stemmed from the district court's ruling that the United States need not demonstrate as an essential element of a so-called securities manipulation scheme that a purchaser and/or seller of securities was deceived by virtue of a misrepresentation or non-disclosure. That incorrect decision of the district court, subsequently affirmed by the Third Circuit, permitted the United States to undertake a form of Rule 10b-5 criminal prosecution which is unprecedented in our jurisprudence. The United States did not prove any misrepresentation or non-disclosure.

It should be emphasized that this Court is presented with an opportunity to resolve in unqualified terms whether deception of an identifiable purchaser/seller remains an element of a Rule 10b-5 stock manipulation case. In so doing, in the context of the present case, this Court must also determine whether transactions based completely on lawful market strategies and devices may be prosecuted as a manipulative device or contrivance.[1] Absent evidence of a misrepresentation or non-disclosure, this Court must propound a negative response to the United States' effort.

II. THE UNITED STATES' PROOFS

In its opinion the Third Circuit Court of Appeals in its opinion set forth a factual explication of the United States' proofs which is inconsistent with the district court's rulings and the actual evidence. The United States continues to deny that it failed to prove that

1. It is also highly significant here that over-the-counter stocks are at issue. Those stocks are not traded in an open and efficient market where information, including price, is openly disseminated. In this regard, we stress that no rules were extant in 1988 respecting domination and control of penny stocks and corresponding disclosure.

petitioner engaged in any practice which violates the law or SEC rules and regulations applicable in 1988. The district court so instructed the petit jury. As a result of the district court's rulings, the singular issue at trial was an intent to defraud in connection with participation in otherwise wholly lawful and fair market practices. Petitioner was convicted only because the district court misinstructed the jury that the United States was not required to prove a misrepresentation or non-disclosure in connection with an identifiable purchase or sale of a security. What we perceive as a balanced presentation of the United States' actual proofs is set forth below.

i. Expert Testimony

a. Robert Lowry

Robert Lowry is employed by the Securities and Exchange Commission. Lowry was presented by the United States as an expert in securities matters. Lowry had no fact-specific understanding of the instant matter and his testimony was generalized. The United States inquired of Lowry "How are stock prices supposed to be determined in the over-the-counter market?". Lowry replied that "stock prices are supposed to be determined by the results of supply and demand". In this context, at the United States request, Lowry uttered a definition of the "term free-trading market".

According to Lowry, a "dominated and controlled market" is the "opposite of a free-trading market". Lowry thereafter offered his personal opinion unsubstantiated by statute or case law that "all stock markets [are] supposed to be free-trading markets including the over-the-counter stock market". In contrast to that unqualified statement, Lowry was constrained to concede on cross-examination that in 1988 no SEC rules or regulations existed respecting domination and control of the penny stock market. Subsequent to 1988, rules were established relative to penny stocks which incorporated regulations relative to domination and control.

b. Martha Fulford

Martha Fulford is also employed by the Securities and Exchange Commission. Like Lowry, Fulford was presented as a securities expert. Fulford explained the manner in which a "blind pool company [could] become a public company". Fulford testified that a blind pool may become public "through an initial public offering of securities". Absent an exemption, "if a blind pool company wanted to become public company through a public offering of securities . . . it would be required to register the securities with the SEC". Securities are registered with the SEC "by filing a registration statement". The "basic purpose of filing a registration statement and registering securities with the SEC is to provide full disclosure to the investors."

When the SEC receives a registration statement, "the staff reads it, reviews it [and] issues comments." The issuer thereafter responds to the comments. And, subsequent to a final review, the SEC declares the registration effective. A declaration that the registration is effective "means that the company may proceed to sell its securities". The company thereafter commences the process by distribution of its prospectus to potential investors. In the event that a fundamental change in the information set forth in the prospectus develops after the effective date of the registration statement, the issuer must cease the offering and file an amendment. The amendment is required to disclose the fundamental change. The offering may not continue until the amendment has been declared effective by the SEC.

Fulford testified that a "public distribution" of securities is required during an initial public offering. Fulford defined a public distribution as requiring that "securities shall [be] distributed to people who are not controlled by the issuer, by its promoter [or] by its parent". Subsequent to the "closing of an initial public offering," wherein the offering has operated on a best efforts basis, "the broker/dealer will meet with the issuer and pay the money over to the issuer and the issuer will provide

the securities to the broker to distribute to its customers". Public trading or "after market trading" commences at this point.

ii. Sheffield Securities

Sheffield Securities, a brokerage firm located in Florida, acted as the underwriter in the initial public offerings primarily at issue in the indictment. The individuals who constituted the principals of Sheffield entered pleas of guilty to conspiracy and securities fraud relative to their dealings in Vista Capital, Castleton Investors Corporation and Bellatrix Corporation. The pleas were in return for cooperation and testimony in the instant trial.

a. Ronald Martini

Martini disregarded an SEC debarment in 1985. At that time, he agreed to become an undisclosed principal in Sheffield Securities. Specifically, he started that business with John LaSala and Alan Weinstein. LaSala and Weinstein were aware that Martini was barred legally from being a principal and/or employee in a securities business. When Sheffield Securities commenced operating, it maintained six to eight employees. LaSala and Weinstein were disclosed principals. Ron Spencer subsequently became a disclosed principal. Sheffield specialized in "a lot of penny stocks, over-the-counter, bulletin board, pink sheet stock."

Petitioner and Barry Davis contacted Sheffield in 1988 concerning "a company named Vista Capital Corporation." Martini testified that "it was a deal that [Davis and petitioner] were putting together and they wanted Sheffield to become the underwriter and we accepted it." Martini explained that "Sheffield was going to bring that IPO public [and] be the main underwriter [and] sell the deal out". Vista was formed as a "best efforts offering." Martini testified that petitioner had a consulting agreement with Vista.

Vista filed a registration statement and was declared effective on February 22, 1988. A prospectus was prepared which

"incorporated [a] complete history of the company." The prospectus stated 50,000 units were being distributed at $10.00 per unit. The prospectus warned potential investors that the securities offered "are highly speculative, involve a high degree of risk, and should be purchased only by persons who can afford to lose their entire investment."

The prospectus further stated that the "company intends upon completion of this offering to seek potential business ventures which in the opinion of management will provide a profit to the company". Simply stated, the company did "not have a specific plan". The prospectus described the company as a blind pool and incorporated a definition of the term.

Martini adopted the government's simplistic position that is the "underwriter's responsibility to allocate the units in the initial public offering". It should be emphasized that Martini's position contrasted with the statement in the prospectus that "the company anticipates providing the underwriter with a list of persons whom it believes may be interested or who have contacted the company with interest in purchasing the units".

Vista because of the interest generated by petitioner's involvement ultimately sold sufficient securities during its initial public offering to successfully close it. Thereafter, Vista merged with Bima Entertainment. Martini and Sheffield thereafter agreed to act as underwriters in an initial public offering relative to a company named Bellatrix Corporation. Bellatrix was "a blind pool just like Vista". Moreover, similar to the circumstances in Vista, petitioner was hired by Bellatrix as a consultant. Furthermore, Ivan Kerzner was the president of both Vista and Bellatrix. The Bellatrix prospectus was essentially identical to the prospectus disseminated relative to Vista. In November of 1988 Bellatrix became a public company.

Martini testified that the prices of Vista and Bellatrix were manipulated. He testified that the stocks were manipulated both in

the IPO and after-market trading. Martini stated that Sheffield abdicated its responsibility as underwriter by virtue of the manner in which it "took instructions from Barry Davis [and] petitioner". Specifically, Martini focused on the factor that Davis and petitioner "made the decision on who got the allocations in the Vista and Bellatrix IPO's".

Martini testified that he was also involved with petitioner and Davis in manipulation of the stock of a company named Castleton Investors Corporation. In 1986 Castleton became a public company through an initial public offering wherein Sheffield acted as the underwriter. In 1988 Castleton agreed to merge with G. Gordon Liddy and Associates. The merger was arranged by Martini and John LaSala. They met with the president of Liddy and Associates in Florida. Castleton was essentially a public shell and Liddy and Associates would achieve public status plus an infusion of capital as the result of a merger.

In August of 1988 Castleton and Liddy Associates signed a letter of intent to merge. The letter was publicized by virtue of press and news releases. Castleton issued a press release on August 18, 1988. The press release prompted an article in the USA Today newspaper. The announcement relative to the merger caused Castleton stock to rise "from 14 1/2 cents to approximately 60 to 65 cents". However, the merger did not ultimately occur. The merger "fell through" in November 1988 and the price of the stock decreased to approximately "10 cents and even lower". Martini stated:

> Problems developed with the G. Gordon Liddy Company. They had an IRS problem. They were not paying their taxes. When this was uncovered it stopped everything dead in its tracks.

b. Ronald Spencer

Spencer met Ron Martini in 1986. He also was introduced to Alan Weinstein and John LaSala at that time. As was previously

indicated, those individuals were the principals of Sheffield Securities. Spencer stated that "they were looking to hire somebody as a trader and also they needed somebody with [a] principal financial license so they could open a brokerage firm". Spencer agreed and assumed a position at Sheffield. He reported to John LaSala on a daily basis.

In 1988 Martini, Weinstein and LaSala advised Spencer that Sheffield would commence business dealings with petitioner and Davis. Spencer testified that he thereafter traded Vista, Castleton and Bellatrix "at the direction of Davis and [petitioner]". Martini and LaSala advised Spencer that Davis and petitioner placed the majority of the stock in those offerings. They further advised Spencer that Davis and petitioner had "control over all the stock or almost all the stock that was issued".

c. John LaSala

LaSala approached petitioner concerning Bellatrix. LaSala recommended that petitioner intercede in the IPO and assume a controlling interest. Prior to this conversation, Bellatrix had raised only $10,000 of the $250,000 needed to close the deal. Petitioner responded to LaSala that he would acquire the stock and file a corresponding post-effective amendment. LaSala stated that petitioner and Davis determined the allocations during the balance of the Bellatrix IPO.

iii. John Marsala

Marsala was employed at a firm named Douglas Stuart. Petitioner contacted Marsala concerning the Vista IPO. Petitioner "wanted [Marsala] to get involved in the initial public offering of the stock and to put indications for [his] retail client". Marsala recited the conditions that

> if [he] bought the stock in the initial public offering, [he] would have to buy stock in the after-market

> [and] hold that stock until [he] was told by [petitioner] or Davis that [he] was allowed to sell.

iv. Barry Davis

Davis met petitioner in 1983 or 1984. Thereafter, in 1987" [petitioner] called [Davis] and suggested [they] get together". An agreement was negotiated and petitioner and Davis "decided to go into business together". A corporation was subsequently formed. Petitioner was to receive 50 percent of all the profits of that corporation. That corporation was named Princeton Financial.

Davis' testimony as to his and petitioner's activities and conduct relative to Vista, Castleton and Bellatrix was essentially consistent with the testimony of the Sheffield Securities witnesses and Marsala. With specific regard to Vista, Davis stated that his and petitioner's objective "was to make money, as well as . . . to ultimately make a good decent company out of it". In this context, it was petitioner's role to "do the investments banking portion" and Davis' function to "do the promotion portion".

Davis testified that Bellatrix was represented to him by petitioner as being essentially identical to Vista. Davis stated that he and petitioner " determined who was going to get the allocation of securities in the initial public offerings of Vista and Bellatrix". Davis further stated that "[he] had a large influence on it but predominantly [petitioner] determined" and had the final say.

Davis described his and petitioner's activities concerning Castleton. Petitioner and Davis "purchased almost all of the units of Castleton". The purchases were easily accomplished because "it was an in-house deal of Sheffield [and] they had all the stock [and] they just pulled it". Davis testified that "within less than 90 days [the stock] was up a thousand percent, ten times".

Davis testified that when "[he] guaranteed market makers to go up and down . . . [he] was not aware that was a crime". He stated:

> I didn't believe protecting a market maker on a particular price and telling him to go up or down was doing something wrong . . . I argued with the government for quite a long time . . . even — up until the time [I] pleaded [I] thought that having the market maker to go up and down was correct [and] I didn't even believe the government when they tried to convince [me] . . . Agent Cahill expressed to me that was illegal. I didn't accept his opinion.

Davis testified that he at no time involved himself in "outright fraud". *Indeed, Davis stated that there were no false statements uttered by him and/or petitioner.* Davis testified that he had no intent to break the law. Davis unequivocally stated that "all three companies were designed and intended to be functioning companies, rewarding their investors with profit". Subsequent to the FBI raid of his home and offices, Davis discussed the instant matter with petitioner. Davis was advised by petitioner that "he didn't think that he did anything wrong". Petitioner stated "we could win the case".

v. Frank Grillo

Grillo and Irwin Frankel opened Allegiance Securities in July of 1988. Allegiance purchased the assets of Greentree Securities in a deal arranged by petitioner. Davis discussed Vista with Grillo during the initial public offering relative to that company. Davis "said that there was a movie company in California, a production company Bima Entertainment that was going to be absorbed by the blind pool". Grillo thereafter entered into an agreement with Davis "concerning the manner in which [his clients] would trade Vista stock in after-market trading". With respect to the agreement, Davis stated that "he had to clear it with [petitioner] as far as the after-market buying was concerned".

Grillo became involved in both Castleton and Bellatrix. Grillo was told by Davis that Castleton "was a blind pool that was going

to absorb the company [named] G. Gordon Liddy". Davis and petitioner thereafter informed Grillo "that [he] would buy the stock at a certain level at like 5/8 of a dollar and wait until the stock went to about a buck and [he would] he able to sell at a dollar". In return, Grillo and Frankel were to receive some stock at a lower price than the market. Grillo realized a profit of $3,630 in about a two-week period "from trading in Castleton.

III. THE DEFENSE

i. Fact Witnesses

a. Robert Kroner

Kroner graduated from Harvard Law School in 1955 and practices law in New Jersey. Kroner was an officer of Vista. Kroner disputed the claim that petitioner participated "in the direction of [Vista] and the decision to merge [with Bima]". Kroner and the other directors, Ivan Kerzner and Michael Kaye, independently made such determinations.

b. Marvin Rosenblum

Rosenblum at the time of trial was employed in the mining and refining business. Rosenblum purchased stock in Vista for the benefit of the Rosenblum family trust. Rosenblum was not restricted in his ability to trade the stock in any fashion. Rosenblum sold the stock in August or September of 1988 because "[his] daughter was about to get married [and he] required the funds for the wedding".

c. Edwin Bell

Bell is a stockbroker in Freehold, New Jersey. Bell disputed Davis' claim that he was paid $7,000 in return for purchasing Vista and Castleton stock for his customers. So too, Bell denied that he agreed "to hold that stock or to restrict its sale in any way". And, Bell was at no time promised "rewards in terms of stock

below the market price, cash, or any other encouragement or reward for holding stocks and for restricting the market".

d. Barry Witz

Witz is an attorney. He worked for the SEC in Washington, D.C. from 1966 to 1971. In mid-1988 Witz was hired by Vista Capital "to represent them in a proposed merger with a company identified as Bima Entertainment." Prior to settling on Bima, the company reviewed several other proposals. Witz was hired by Ivan Kerzner. Kerzner was "in charge of negotiations" and signed the letter of intent. Witz communicated with the lawyers for Bima and "sort of fought over everything". The letter of intent "said there was no obligation [because] Kerzner . . . was still looking at other things". There was no certainty relative to the merger "until . . . the press release went out [after] the accountants had been talked to [and] one got the feeling that financials were being kept properly".

ii. Expert Testimony

a. James Cunningham Sargent

Sargent is an attorney and former commissioner of the SEC. He was appointed a SEC Commissioner and sworn in by President Eisenhower in June of 1956 and remained in that position until October 1960. At the time of trial, Sargent was associated with the law firm of Oppenheimer Gottlieb Feiler Katz and Katz in New York City. Sargent's entire law practice has related to SEC matters. In this context, Sargent was also chairman of the small business committee of the American Bar Association's business and banking and business law section from 1961 to 1990.

Sargent testified that stocks rise in price for various reasons unrelated to supply and demand. For example, a stock may rise "because somebody has the feeling [based upon what] he sees in the stock itself or in the persons that are going to buy the stock". Sargent testified:

> If you take a fellow like Iacocca, have him buy the stock, people are going to jump in because he's there . . . [This is true] to an even greater extent in penny stocks in my view because you're only paying a penny.

Sargent disagreed with Lowry's definition of a free-trading market. Sargent testified that

> the question as to whether it trades because of supply and demand . . . has nothing to do with what makes a market work, either up or down . . . little to do with whether a market trades up or down.

In Sargent's view, a free and open market is compromised only by "false and misleading statements . . . that permeate the market".

With respect to a merger decision, the officers and directors of the company "must make the decision". A letter of intent to merge is merely a first step. Sargent reviewed the Castleton letter of August 11, 1988 expressing its intent to merge with Liddy. Sargent stated "it would be misleading to disclose such a letter to the public". Sargent stated that "it would attract people to jump into the market [and] buy some of the securities". The problem is that "the market would go up [and] if the merger did not occur, they would lose their money". Sargent specifically disagreed with Fulford's claim that such a letter would mandate the filing of a post-effective amendment. Sargent elaborated:

> Whenever you merge two companies together, one of which is registered with the SEC, you'd have to file a post-effective amendment to show that the merger has actually been consummateds . . . In order to do that, you got to be able to establish [that] these companies have financial statements, both companies, which will pass muster with the SEC, that is they must be certified by an outside independent auditor who has to verify their financial

> viabilitys . . . Until you have both companies able to satisfy that requirement, you would not be in a position to file a post-effective amendment. There could be no possible merger.

Penny stocks are a unique market. Sargent stated that "many people don't want to buy penny stocks because [the companies] have no assets". Sargent stated:

> You've got to be willing to lose all your money. This is a risky venture. It has no assets. That there's absolutely nothing. It does not have any manufacturing business. It doesn't have anything at all except, and this is the pie in the sky, except an opportunity to merge with some viable company, some company that has a product. A widget, a little game, something he's built in his garage, he wants to go public and manufacture.

Sargent also reviewed the June 30, 1988 Vista letter of intent to merge. The letter was characterized by Sargent as merely a "possibility at some future date [of] agreeing to agree". Sargent testified that disclosure of the letter to the public "would be a direct violation of Rule 10b (5)". He stated:

> [The letter] says it should not be disclosed. It says there's confidential information. It must not be disclosed until we agree to some definitive agreement. Any purchaser that goes into a penny stock gets a copy by law of this prospectus. Anyone who reads this prospectus and the risk factors either has to be a very sophisticated investor or he ought to have his head examined.

Sargent iterated that there is nothing "wrong in terms of the customs and practices of the securities market in having domination and control" over a penny stock. Indeed, domination and control

are positive aspects because these elements contribute to orderliness and stability. Sargent testified:

> [Domination and control] contributed to a orderly marketplace as the basic purpose of any stock is to try to create a situation where you have a merger candidate willing to merge with that company. Unless you have that penny stock company in some form of orderly availability, no company is going to merge with it. If you have stock that's flip flopping up and downs . . . the company that wants to merge with it isn't going to merge with it.

Sargent thereafter responded to three hypothetical questions specifically based upon the facts adduced at trial. The first hypothetical related to the Vista transaction. With respect to the Vista hypothetical, Sargent testified that "these activities were consistent with federal securities laws". He further stated that these activities "were consistent with the habits and conditions of the penny stock market". In this context, he emphasized that securities law was not breached "when certain inducements were offered to brokers".

Sargent thereafter considered a hypothetical based on the facts adduced relative to Castleton. Sargent in response testified that petitioner's activities in Castleton were consistent with applicable federal securities laws. Sargent concluded his testimony with a response to a hypothetical predicated upon the facts adduced relative to the Bellatrix transaction. Sargent in response testified that the activities "did agree with the applicable securities law applicable to this type of transaction".

b. Raymond L. Dirks

Dirks has worked in the securities industry from 1955 until the present. In 1969 he formed a firm called Dirks Brothers. That firm functioned as a broker/dealer; researched insurance company stocks and newspaper company stocks, and made markets in over-

the-counter stocks. Dirks Brothers was registered with the SEC. In 1973 Dirks discovered "the largest insurance and financial fraud of all times". He reported the fraud to the SEC and in return was "charged with civil violations relating to inside information". The charges were thereafter sustained by the SEC. Dirks appealed to this Court and achieved reversal of the SEC decision. In 1974, Dirks wrote a book titled "The Great Wall Street Scandal". He is presently employed by a firm named Coleman Handco Securities in New York City.

Dirks testified that consultants and others routinely discuss mergers with other persons before they are finalized. Dirks stated that such talk does not require disclosure to the public of the potential merger. He testified:

> It would be extremely unwieldy to have comments coming out of companies every time they share any sort of discussions . . . there are also other companies that might be competitors in that acquisition process. So you don't want other people to know you're discussing.

Dirks stated underwriters customarily select the people who will receive allocations in an IPO. In this context, underwriters seek the advice of consultants and/or promoters engaged by the company as to prospective buyers of the stock. This is particularly true with blind pools because they are "relatively unknown offerings". Indeed, it is common that promoters and consultants have the discretion "to suggest, approve or deny placements". Moreover, persons who purchased stock in the IPO are "almost always" solicited for after-market orders. Similarly, it is customary to offer inducements to brokers to encourage them to bring in subscribers. These inducements include bonuses and warrants. It is also customary for the consultants, promoters and underwriter to negotiate opening prices. Dirks has personally been involved "in well over a hundred public offerings".

On the basis of the foregoing evidence, petitioner was convicted of conspiracy, mail fraud and wire fraud. The Third Circuit affirmed.

This Petition for Certiorari follows.

REASONS FOR GRANTING THE WRIT

I. CERTIORARI SHOULD BE GRANTED TO FACILITATE A DEFINITIVE RULING AS TO WHETHER PROOF OF DECEPTION IN CONNECTION WITH AN IDENTIFIABLE PURCHASE OR SALE OF STOCK IS AN ESSENTIAL ELEMENT OF A STOCK MANIPULATION PROSECUTION.

In ruling that "reliance is [not] an element of the crime of stock manipulation", the Third Circuit effected a stark precedential departure from past analyses of Rule 10b-5 criminal prosecutions based upon alleged stock manipulation. Indeed, it created a clear conflict between it and the Second Circuit. So too, a further component of the decision is that the Court found that the United States and/or a private litigant has a greater burden of proof in a civil Rule 10b-5 action than is applicable in a criminal prosecution based upon the same rule. There is no dispute that a private civil litigant must prove reliance. *See In re Burlington Coat Factory Securities Litigation*, 114 F.3d 1410, 1419 (3rd Cir. 1997). The effect of such a ruling is dissolution of a principle of longstanding, viz, the burden of proof where liberty is at stake is greater than where monetary considerations is the singular issue.

We submit that the Third Circuit's ruling is abjectly devoid of authoritative support. Indeed, the ruling is inconsistent with the most recent Rule 10b-5 analysis of this Court in *United States v. O'Hagan, supra*. The ruling is particularly over-broad and "chilling" relative to persons who are involved in the profession of investing, stock promotion and brokerage sales. The ruling authorizes the imprisonment of persons for alleged stock

manipulation who have not been demonstrated to have deceived a purchaser or seller of a security by virtue of a misrepresentation or non-disclosure. Simply stated, the ruling purports to empower Rule 10b-5 criminal prosecutions of "deceptive devices" in the abstract. However, recovery of money in a Rule 10b-5 civil action nonetheless depends upon proof of reliance or a presumption of reliance where the stocks are sold in an open and efficient market as opposed to over-the-counter. *In re Burlington Coat Factory Securities Litigation, supra* at 1419, n.8. A review of this Court's recent decision in *United States v. O'Hagan, supra*, and related precedent establish the clear error of the Third Circuit and mandate a reversal of the decision below.

i. *United States v. O'Hagan*

a. The Misappropriation Theory

In *United States v. O'Hagan, supra* at 2205, this Court considered the issue of whether

> a person who trades in securities for personal profit, using confidential information misappropriated in breach of a fiduciary duty to the source of the information, is guilty of violating § 10(b) and Rule 10b-5.

The Court's "answer to these . . . question [was] yes". *Id.* The defendant in *O'Hagan* was a partner in a law firm which represented a client regarding a potential tender for the common stock of Pillsbury Company. The law firm took precautions to protect the confidentiality of the tender offer plans. However, the defendant misutilized his position of confidence and began purchasing call options for Pillsbury stock. He ultimately realized a profit of more than $4.3 million.

The theory upon which the defendant in *O'Hagan* was prosecuted is descriptively termed "the misappropriation theory". Prior to this Court's decision to ratify the misappropriation theory

in *O'Hagan*, a distinct minority of federal circuits recognized the theory as viable. And, within the two year period immediately preceding this Court's opinion in *O'Hagan*, the Fourth and Eight Circuit Courts of Appeals rendered opinions rejecting the theory on the ground that it was not encompassed within § 10(b) and Rule 10(b)-5. *See United States v. Bryan*, 58 F.3d 933, 950 (4th Cir. 1995); *United States v. O'Hagan*, 92 F.3d 612 (8th Cir. 1996), *rev'd*, __ U.S. __, 117 S. Ct. 2199 (1997).

This Court in *O'Hagan* described § 10(b) as proscribing (1) using any deceptive device; (2) in connection with the purchase or sale of securities, in contravention of rules prescribed by the SEC. The Court stated that the provision does not confine its coverage to deception of a purchaser or seller of securities Rather, the statute reaches any deceptive device used "in connection with the purchase or sale of any security". *United States v. O'Hagan, supra* at 2206-2207. As stated above, the precise ruling of this Court in *O'Hagan* is that § 10(b) and Rule 10(b)-5 are violated when a person "misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information". *Id.* The Court stated in *O'Hagan* that the "misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information." *Id. See Santa Fe Industries v. Green*, 430 U.S. 462 (1977) (§ 10(b) trains on conduct involving manipulation or deception).

The *O'Hagan* Court painstakingly analyzed the § 10(b) requirement that the deception be in connection with the purchase or sale of a security. The *O'Hagan* Court stated that "this element is satisfied because the fiduciary's fraud is consummated, not when the fiduciary gains the confidential information, but when, without disclosure to his principal, he uses the information to purchase or sell securities". *Id.* at 2209. *The Court in O'Hagan succinctly stated that "the securities transaction and the breach of duty thus coincide". Id.*

b. The Definition of Manipulation

The *O'Hagan* Court iterated the definition of manipulation in the context of a corollary issue before it respecting Rule 14e-3(a). The Court in *O'Hagan* stated that

> the word manipulative in the § 14(e) phrase fraudulent, deceptive manipulative acts or practices means just what the word means in § 10(b): Absent misrepresentation or non-disclosure, an act cannot be indicted as manipulative.

117 S. Ct. *supra* at 2216. *See Schreieber v. Burlington Northern, Inc.*, 472 U.S. 1, 7-8 (1985). The Court in *O'Hagan* further admonished those who would interpret its opinion that Rule 10b-5 may prescribe only conduct that § 10(b) prohibits. 117 S. Ct. *supra* at 2217, n.18. In short, any Rule 10b-5 stock manipulation prosecution must incorporate a misrepresentation or non-disclosure in connection with the purchase or sale of a security. *Indeed, "the securities transaction and the [misrepresentation] must coincide". United States v. O'Hagan, supra* at 2209.

ii. *United States v. Wynn*

The Court in *Wynn* described the argument of petitioner stating the "convictions should be reversed because the government did not prove that investors actually relied upon fraudulent and manipulative practices in purchasing the subject securities". *United States v. Wynn, supra* at 549. As was noted above, the *Wynn* Court thereafter framed the specific question before it as "whether reliance is an element of the crime of stock manipulation." *Id.* In its ruling, the *Wynn* Court stated that "neither the statute nor the rule includes a reliance requirement". *Id.* However, the Court in *Wynn* simply and correctly described the prohibition as "employment of manipulative and deceptive devices *in connection with the purchase or sale of securities*" *id.* It is the misapprehension as to the "in connection with a purchase or sale" requirement which degraded the cogency of the *Wynn* Court's ratiocination.

Specifically, the *Wynn* Court's reasoning was derailed by its misreading of *United States v. O'Hagan, supra*, and incorrect application of *United States v. Naftalin*, 441 U.S. 768 (1979). The Court misread the *O'Hagan* inclusion of the misappropriation theory within Rule 10b-5 as excluding "deception on a purchaser or seller of a security" as a requirement of an alleged stock manipulation. *United States v. Wynn, supra* at 550. Contrary to the *Wynn* Court's analysis, this Court in *O'Hagan* specifically stated that the misrepresentation and securities transaction "must coincide". *United States v. O'Hagan, supra* at 2209.

More egregiously, the Third Circuit citing *Naftalin* stated that

> if fraud in a securities transaction, as prohibited by the 1933 Act, does not require fraud on an investor, then deception in connection with a securities transaction per the 1934 Act does not have such a requirement.

Id. at 550. The Third Circuit failed to comprehend that *Naftalin* analyzed § 17(a) of the 1933 Act. Unlike § 10(b), that provision does not incorporate the "in connection with the purchase or sale of a security" requirement. Thus, there is no rational basis for comparing § 17(a) and Rule 10b-5 in the context of the reliance argument. So too, the *Wynn* Court would have been better focused had it understood this Court's comment in *O'Hagan* that "Rule 10b-5 may prescribe one conduct that § 10(b) prohibits". 117 S. Ct. *supra* at 2217, n.18.

iii. The Opinion Of The Third Circuit Court Must Be Reversed

a. The Conflict With The Second Circuit

In *United States v. Persky*, 520 F.2d 283, 288 (2nd Cir. 1975), the Second Circuit affirmed legal instructions correctly setting forth the elements of a stock manipulation. The United States must

demonstrate that there were purchases or sales of securities or both and that the device or scheme employed or act or practice was of a sort that would cause reasonable investors to rely thereon and in connection therewith they so relied. *Id.* Thereafter, consistent with the decision in *O'Hagan*, the Second Circuit also recognized the misappropriation theory as being within Rule 10b-5. *See United States v. Newman*, 664 F.2d 12, 16-17 (2nd Cir. 1981).

More importantly, post-*Persky* and *Newman* the Second Circuit affirmed the requirement of reliance in stock manipulation criminal prosecutions in *United States v. Russo*, 74 F.3d 1383, 1392 (2nd Cir. 1996). *See Santa Fe Industries, Inc. v. Green, supra* at 470 (Deception prescribed in § 10(b) is the making of a material misrepresentation or the non-disclosure of material information in violation of a duty to disclose); *Central Bank of Denver N.A. v. First Interstate Bank of Denver*, __ U.S. __, 114 S. Ct. 1455 (1994) (Noting requirement of manipulative device on which a purchaser or seller of securities relies). Specifically, the Court in Russo affirmed the right of the defendant in a Rule 10b-5 stock manipulation prosecution to an instruction that the jury may not render a guilty verdict absent proof that the victim was deceived. 664 F.2d *supra* at 1393.

The progression of the law as formulated by the Second Circuit in *Persky*, *Newman* and *Russo* is completely consistent with this Court's ruling in *O'Hagan*. Recognition of the misappropriation theory as being within Rule 10b-5 (*Newman*) does not in any fashion diminish the reliance element applicable to a stock manipulation prosecution (*Persky* and *Russo*). However, at a minimum the decision of the Third Circuit herein creates a clear conflict between it and the Second Circuit. Accordingly, defendants prosecuted in New York will be acquitted absent proof of reliance. Defendants similarly situated in Pennsylvania and New Jersey will be convicted.

We submit that this Court has no just option other than to grant certiorari and correct the error of the Third Circuit. Individuals geographically situated less than 10 miles from Wall Street in New

Jersey will be prosecuted for an offense that does not exist in the Second Circuit. That is a component of the injustice herein. The primary injustice is that the Third Circuit opinion is in error. The *Wynn* Court has created a new theory of Rule 10b-5 liability that did not previously exist. In this context, any conviction pursuant to this previously unknown theory must be reversed. Petitioner may not be imprisoned because he "had no knowledge of the rule" authorizing a criminal conviction absent proof of reliance. *United States v. O'Hagan, supra* at 2214. *And, because the United States had no proof of reliance, petitioner was entitled to an acquittal.*

b. There Was No Misrepresentation or Non-Disclosure

1. Inducements and Domination and Control

Various factors are critical to a clear understanding of the injustice inherent in the conviction at issue. Mischaracterization of conduct as *per se* illegal when it was, in fact, lawful has created a miasma of prejudice. The United States and Third Circuit referred to inducements allegedly paid to brokers as "bribes" despite the indisputable fact that all such payments were lawful and consistent with fair market practices. *See* SEC "Committee on Compensation Practices "Report dated April 10, 1995. Therefore, there can be no misrepresentation or non-disclosure issue relative to such payments. However, those payments remain as fodder for rhetorical distortion by the United States.

More importantly, there were no rules respecting domination and control of penny stocks applicable in 1988. In 1990, subsequent to the events in this matter, the Penny Stock Reform Act was passed. The Act essentially imposed disclosure requirements respecting domination and control. Simply put, the Act required insertion of a disclosure statement within the prospectus. The disclosure statement within the Act (§ 15(a)) provides *inter alia*:

> Market domination. In some cases, one or two dealers, acting as "market makers," may be buying and selling a given stock. You should first ask if a

> firm is acting as a broker (your agent) or as a dealer. A dealer buys stock itself to fill your order or already owns the stock. A market maker is a dealer who holds itself out as ready to buy and sell stock on a regular basis. If the firm is a market maker, ask how many other market makers are dealing in the stock or see if the firm (or group of firms) dominates the market. When there are only one or two market makers, there is a risk that the dealer or group of dealers may control the market in that stock and set prices that are not based on competitive forcess . . .

Therefore, because no disclosure requirements existed, there can be no claim that a non-disclosure or misrepresentation stems from the fashion in which the stocks were controlled in 1988.[2]

2. Price

Although no misrepresentations or actionable non-disclosures were alleged at trial, the United States has on appeal raised the argument that the price of the stocks constituted a misrepresentation because of the fashion in which the issues were controlled. Because there was no proscription against domination and control, and no disclosure requirements, no reasonable investor could assume that the 1988 price of a penny stock was in any fashion related to value or any other consideration. Moreover, penny stocks were traded in a closed and inefficient market. *See Part C, infra.* Indeed, we emphasize that the prospectus of each company warned investors that the securities offered "are highly speculative, involve a high degree of risk, and should be purchased only by persons who can afford to lose their entire investment". *See In re Donald J. Trump*

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2. Even assuming the existence of disclosure requirements as to inducements, domination and control, and/or merger plans, it is indisputable that petitioner was at no time in a position where he had a duty to speak. *See Weiner v. Quaker Oats*, 129 F.3d 310, 316 (3rd Cir. 1997). This fact explains the failure of the United States to allege any actionable non-disclosure by petitioner.

Casino Securities Litigation, 7 F.3d 357, 371 (Cautionary language in the offering document negated the materiality of a alleged misrepresentation or omission — the bespeaks caution doctrine). Therefore, there is simply no basis upon which price may be asserted as being a misrepresentation or in any way deceptive. *See Zlotnick v. Tie Communications*, 836 F.2d 818, 823 (3rd Cir. 1988).

c. The Criminal/Civil Burden of Proof Issue

As was noted above, the Second Circuit clearly requires proof of reliance in both criminal and civil Rule 10b-5 actions. Indeed, all circuits require proof of reliance in civil actions unless the action is merely seeking injunctive relief or reliance is presumed because the stocks are traded in an open and efficient market as opposed to the over-the-counter market. *See Peil v. Speiser*, 806 F.2d 1154 (3rd Cir. 1986); *Zlotnick v. Tie Communications, supra* 821; *Lewis v. Chrysler*, 949 F.2d 644, 650 (3rd Cir. 1991). Our position is that the Second Circuit is consistent with this Court's opinion in *United States v. O'Hagan, supra.* So too, we emphasize that prior to the decision of the Third Circuit, no other Court espoused the view that reliance is not an element of a Rule 10b-5 criminal prosecution. This fact explains the Third Circuit's incongruous resort to *Naftalin* as support for its truly divergent opinion. No Court of Appeals decisions support its conclusion.

In the trial below, petitioner advised the district court that the United States' only basis for its position that it need not prove reliance would have to be that the fraud-on-the-market theory was applicable. In Rule 10b-5 civil cases, as noted above, reliance may in certain jurisdictions be presumed where a misrepresentation or non-disclosure is at issue relative to a stock traded in an open and developed market. *See Wiley v. Hughes Capital Corp.*, 746 F. Supp. 1264, 1288 (D.N.J. 1990). However, the stock must trade is an open and efficient market as opposed to the over-the-counter market. The clear inefficiency of the over-the-counter market precluded fraud-on-the-market as an optional theory for the United States. In this context, we observe that price is only a reasonable

indicator of value in an open and developed market. *Id. See LaChance v. Harrington*, 965 F. Supp. 630, 642 (E.D. Pa. 1997) (Fraud on the market theory rebutted by proof that market in which stock was traded is inefficient). *Cf. Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988); *Hayes v. Gross*, 982 F.2d 104, 107 (3rd Cir. 1992).[3]

In *Hayes v. Gross, supra* the Third Circuit set forth its accepted definition of an open and efficient market. The Court in *Hayes* stated:

> . . . various [facts]s . . . could support an inference that the market for a security was efficient, including: (1) allegations of a large average trading volume; (2) allegations that a significant number of securities analysts followed and reported on the security; (3) allegations that the security had numerous market makers; (4) allegations that the company was entitled to file SEC form S-3 Registration Statement; and (5) allegations of facts showing a causal connection between unexpected corporate events or financial releases and an immediate response in stock price. [982 F.2d supra at 107]

There is no basis upon which this Court may allow the United States to reduce the burden of proof in a Rule 10b-5 criminal prosecution below that which is applicable to the United States and/or private litigants in a Rule 10b-5 civil actions. There is no analogy in our jurisprudence to the circumstance herein where a

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3. The United States misled the grand jury when it alleged that petitioner's alleged "trading . . . practices . . . created a false and misleading appearance of orderly, rational price changer based on legitimate active trading in, and legitimate market demand for these securities". Indictment at page 11, paragraph 16. Over-the-counter stocks are not reported on any accessible basis in terms of price, volume or other aspects. The market is essentially invisible. Therefore, it is not possible to create any misleading appearance.

criminal prosecution under a particular rule has a lesser evidentiary burden than a civil action under the same rule. This Court must be guided by its language in *Blue Chip Stamps v. Manor Drug Stores, supra* at 739. Therein this Court stated that the purchase or sale rule has maintained the balances built into the congressional scheme without undue risk of abuse of the litigation process and without distorting the securities market. This Court's decision in *O'Hagan* did not disturb that rule because the misappropriation theory requires that "the securities transaction and the breach of duty coincide". *United States v. O'Hagan, supra* at 2209. Similarly, this Court must in a stock manipulation prosecution maintain the rule that the securities transaction and the misrepresentation coincide.

II. CERTIORARI SHOULD BE GRANTED TO CLARIFY WHETHER THE UNIT OF PROSECUTION IN A RULE 10b-5 CASE MUST BE THE PURCHASE OR SALE OF A SECURITY WHICH COINCIDES WITH THE MISREPRESENTATION.

Based upon the arguments set forth in Point I, *supra*, we request of this Court as part of a grant of Certiorari herein that the unit of prosecution be limited to a "false statement in connection with a discrete sale". *United States v. Langford*, 946 F.2d 798, 803 (11th Cir. 1991). The Third Circuit below purported to rely upon *Langford* but nonetheless failed to follow the formula therein that a unit of prosecution a Rule 10b-5 stock manipulation case must be restricted to the misrepresentation and the coinciding securities transaction.

CONCLUSION

For the foregoing reasons, we respectfully request that this Court grant certiorari to review the final judgment of the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT FILED JANUARY 21, 1998

Filed January 21, 1998

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 96-5589 and 96-5622

UNITED STATES OF AMERICA

v.

BRAD HADDY, a/k/a Bradley J. Haddy
Brad Haddy,

Appellant in No. 96-5589

(D.C. Crim. No. 93-cr-00558-3)

UNITED STATES OF AMERICA

v.

ERIC WYNN,

Appellant in No. 96-5622

(D.C. Crim. No. 93-cr-00558-1)

Appeal from the United States District Court
for the District of New Jersey

Argued October 20, 1997

Before: MANSMANN and GREENBERG, *Circuit Judges*,
and ALARCON, *Circuit Judge*.*

(Opinion filed January 21, 1998)

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*Honorable Arthur L. Alarcon of the United States Court of Appeals for the Ninth Circuit, sitting by designation.

Appendix A

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Appendix A

OPINION OF THE COURT

MANSMANN, *Circuit Judge.*

Eric Wynn and Brad Haddy appeal from judgments in criminal cases entered by the District of New Jersey after a jury found them guilty of conspiracy to commit securities fraud and of substantive crimes relating to manipulation of the stock market. Wynn was also convicted of wire fraud. After sentencing, Wynn and Haddy appealed, raising a number of assertions of error. Two questions — whether the indictment contained duplicitous counts and whether investor reliance is a requisite of proof to convict under section 10(b) of the Securities Act of 1934 — require discussion. Several other issues, involving constructive amendment of the indictment, statute of limitations, severance, willfulness as an element of the securities law violation, character evidence of a witness, prosecutorial misconduct, admission of evidence, jury instructions, competency and sentencing, are without merit and do not warrant further discussion.[1]

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1. In his brief, Haddy set forth these additional issues as:

> 1. The government failed to prove that he acted willfully, an essential element of the crimes of securities fraud and conspiracy to commit securities fraud;
>
> 2. His right to a fair trial was prejudiced by the district court's denial of his motion for a separate trial;
>
> 3. Prosecutorial misconduct, consisting of the unauthorized use of a grand jury subpoena, offering testimony known to be untrue, lack of a "good faith basis" for asking certain questions of a witness, making baseless arguments that certain assumptions were "incorrect and incomplete" or "misleading," offering a misleading summary chart, and interfering with his attempts to interview witnesses, prejudiced him and required a mistrial;
>
> 4. The district court erred in excluding testimony by opinion witnesses who would impeach the credibility of a principal witness for the prosecution and thus denied him his Sixth Amendment right to compulsory process;

Appendix A

We will affirm the judgments entered. We conclude first, that the indictment does not suffer from the vice of duplicity. The relevant statutory and regulatory language allow charging an overall scheme to defraud in a single count of an indictment. Second, criminal liability under section 10(b) of the Securities Exchange Act does not require deception of and reliance by an identifiable buyer or

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5. The district court erred by admitting financial records obtained pursuant to grand jury subpoena in direct contravention of the Right to Financial Privacy Act;

6. The district court erred by admitting into evidence recordings of intercepted wire communications and evidence derived from these communications;

7. The government failed to apply for or obtain authorization or approval to use or disclose the contents of the intercepted wire communications before the grand jury;

8. The district court erred in refusing to instruct the jury concerning the time at which a sale of a security is deemed complete, venue, legal responsibility, and the need for showing deception and investor reliance; and erred in charging the jury that it might return a verdict of guilty as to Count I (or Counts II, III and IV) without finding unanimously that one of the overt acts charged in the indictment occurred during the limitation period; and,

9. The district court erred in sentencing him by not reducing his sentence to take into consideration that conspiracy is a "lesser included offense" of the continuing criminal enterprise and by incorrectly using the "gross gain secured by the conspiracy as a whole, [by] the co-conspirators and those persons and accounts which they controlled" to compute the amount of loss.

In Wynn's brief, these issues are described as:

1. The district court erred in permitting the government to constructively amend the indictment by altering the theory of the government presented to the grand jury that Wynn's conduct was *per se* unlawful, to an urging before the petit jury that he engaged in lawful activity with a corrupt and manipulative intent; and,

2. The district court erred in determining that the government met its burden of proving Wynn's mental competency by concluding that the panic disorder suffered by him did not render him unable to assist in his defense.

seller of securities. The statute's objective of maintaining the integrity of the stock market forbids deceitful practices without mention of whether investors relied upon the manipulative devices in connection with a securities transaction.

Our jurisdiction is granted by 28 U.S.C. § 1291.

I.

We review the facts in a light favorable to the government, the verdict winner.

A. The Scheme

In approximately 1987, Eric Wynn and Barry Davis formed a company called Princeton Financial Consultants to raise capital for companies and to promote stocks. Through this entity, Wynn and Davis masterminded and directed a number of securities trading scams by designing a plan to artificially raise the prices of particular securities, known as penny stocks. Penny stocks, generally valued at under $5.00 a share, are traded on the over-the-counter market through the National Association of Securities Dealers Automated Quotation system (NASDAQ).

Princeton employees called on brokers and traders throughout the country touting different stocks. The participation of collaborating stockbrokers was essential to the effectiveness of the scheme. One of the brokers who followed the Princeton/Wynn recommendations was Brad Haddy, who sold securities through the Minneapolis brokerage firm of L'Argent Securities.

The manipulation involved four basic steps: (1) control the quantity of stock available for trading; (2) generate demand for the stock; (3) raise the price of the stock; and (4) sell out at a large profit.

Control of the supply of securities was gained by "boxing" the initial public offerings ("IPOs") of securities in particular companies. Boxing refers to an allocation of almost all of the available stock to accounts controlled by "players" — those who had agreed to trade the stock per the direction

of Wynn. One directive required that when the after-trading market commenced — the public trading that occurs after the close of the IPO — the players could not sell the stock until Wynn gave the go-ahead. With this restriction, Wynn was able to control the supply of stock which, in turn, enabled him to regulate the price of the stock.

Step two, generation of demand, was primarily accomplished through bribery of brokers. Colluding brokers sold securities to their customers at prices and from brokerage firms designated by Wynn. The brokers were then instructed to hold the particular stock off the market for a period of time (usually six months). In exchange, the brokers received various inducements, including cash, stock below the market price, guaranteed profits and promises of participation in future deals. Another way Wynn created demand for a particular stock was by secretly advising brokers of impending mergers of certain companies before public announcement of the event.

The next step, the price increase, was realized through pre-arranged and restricted trading in which selected brokers bought stock at steadily increasing prices — again, as directed by Wynn.

Once the price of the manipulated securities rose to certain levels, the inflated value was maintained through deals with "market maker" brokerage firms. These firms represent themselves to the investing public as being willing to sell and trade risky securities. Wynn induced certain market makers to set their buy (bid) and sell (ask) for some securities at prices in accordance with his instructions in exchange for guaranteed trading profits. By manufacturing a demand for these securities, the participants insured their personal profits occasioned by transactions in these securities.

The manipulations detailed in the indictment concern the use of the services of Sheffield Securities, a brokerage firm in Fort Lauderdale, Florida. Sheffield was run by Ronald Martini, who, despite being barred from participation in the securities business, was a secret owner of Sheffield. Wynn entered into an agreement with the principals of Sheffield which allowed him to dominate the initial public offerings of

stocks in certain shell companies underwritten by Sheffield. Wynn would also be permitted to direct the after market trading in these particular securities.

Three security offerings in particular epitomize the scope of the illegal activity and are the subjects of counts 2, 3 and 4 of the indictment.

B. Count 2 – Vista Capital Corp.

The first stock that Wynn and Davis manipulated through Sheffield was Vista Capital Corporation, a company engaged in an IPO. In filings with the Securities and Exchange Commission, Vista was represented as a blind pool, a company with no actual or anticipated business operations. Vista's status was, however, misrepresented. During the period of the IPO, Wynn arranged for a merger between Vista and a film company called Bima Entertainment.

Wynn's plan was to raise money for Vista through an offering of its stock, as a result of which Vista would become a public company. Wynn would then trade Vista securities on the OTC market in a manner that would insure that the price of Vista would rise, enabling the players to make a substantial amount of money. As planned, the price of Vista rose $.11 per share within the first month of aftermarket trading.

In line with the four-step design, Wynn controlled the supply of Vista stock by boxing the Vista IPO — allocating the securities issued to accounts set up at Sheffield. Although the Vista prospectus stated that Sheffield, the underwriter, would make the final decisions concerning stock distribution during the IPO, it was actually Wynn who directed the specifics of the offering. When investors outside Wynn's affiliations requested Vista stock, they were denied the opportunity to participate in the trading. Wynn was able to regulate the trading in the Vista IPO stock partly because Sheffield maintained control over the actual Vista stock certificates. If a "non-playing" customer tried to have Vista stock transferred and sold, Sheffield's clearing agent would so advise Sheffield, who passed on the information to Wynn. The only stock certificate transfers that Sheffield

authorized the clearing agent to effectuate were those allocated to accounts associated with Wynn.

Wynn generated the demand for the Vista stock by offering inducements or bribes to brokers to have their customers buy the stock. One broker, John Marsala, testified that Wynn asked him to have his customers buy Vista stock and hold it off the market. In return, Marsala was offered 100,000 Vista warrants[2] for himself. Although he opted out of participation, he observed another broker putting a stock certificate into his briefcase. Wynn advised Marsala that what he witnessed was a broker receiving the same warrants that had been promised to Marsala if he had participated in the Vista deal.

Bribes were not the only means by which Wynn induced brokers to buy Vista stock. He also encouraged participation by offering non-public inside information. In the case of Vista, brokers, including Haddy, were told that the company would be merging prior to the close of the IPO. Wynn was able to represent the Vista/Bima merger as a certainty because he had arranged the merger through his consulting company, Skyline Capital Corp.

Although the Vista/Bima merger was arranged before the close of the Vista IPO, the Vista prospectus was not timely amended to disclose the information. An expert for the SEC testified that if a blind pool company finds a probable merger candidate before the close of its IPO, the company must stop distributing its securities and file a post-effective amendment with the SEC. Notice to the agency is required because a potential merger would amount to a fundamental change affecting decisions of investors.

Wynn, Davis and Haddy and other players eventually sold their Vista stock at a large profit.

C. Count III – Castleton Investors Corp.

The second stock manipulated through Wynn's control of Sheffield was Castleton Investors Corp., another shell

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2. A warrant is a right to acquire stock at a defined future time and at a specified price.

company. Castleton became a public company through an IPO underwritten by Sheffield in 1986. In late June, 1988, Wynn was advised that a security guard anti-terrorism business owned by G. Gordon Liddy[3] wanted to merge with Castleton. Sheffield expressed its willingness to sell Liddy a majority of the free-trading Castleton stock currently owned by Sheffield customers.

Wynn took over the helm of the Liddy deal. His consulting company, Skyline, entered into an agreement with Liddy for a 30-day exclusive right to find a merger candidate for the Liddy company.

Once Wynn lined up the expected merger of Castleton and Liddy, he and his coconspirators began manipulating the price of stock using the familiar four step process. About 80% of the free-trading stock was acquired by the "players" from Sheffield customers who were not told of the merger.

Haddy was among the brokers promised Castleton stock in exchange for agreeing to have his customers buy a large block of the stock. Two days after a tape-recorded conversation in which Wynn assured Haddy that he would receive stock, Haddy and his L'Argent customers bought 500,000 shares of Castleton common stock.

Demand for Castleton stock was then created by publicizing the intended merger between the company and Liddy. The announcement resulted in additional buying. Sheffield, acting in accordance with Wynn's instructions as to bid and ask prices, then traded the stock in conformity with the previously arranged deals. Profits were thus guaranteed.

D. Count IV – Bellatrix Corp.

Count IV charged a manipulation scheme involving securities from the Bellatrix Corporation, also a blind pool company engaged in an IPO underwritten by Sheffield. The pattern in the Bellatrix trading mirrored that of the Vista

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3. There is no suggestion that Liddy was in any way involved in wrongdoing.

stock manipulation — "box" the IPO, manufacture demand, raise the price through controlled trading, and sell out at a profit. Similarly, the fact of Bellatrix' impending merger with Gamenet, a computer company, was not disclosed to the SEC.

The Bellatrix manipulation was interrupted on the second day of after market trading when the FBI executed search warrants at Wynn's home and, on the next day, at the offices of Sheffield Securities.

E. The Prosecution

On November 15, 1993, a federal grand jury in the District of New Jersey returned an indictment charging Eric Wynn, Brad Haddy, Anthony Nandino, Irwin Frankel and Perry Constantinou with conspiracy to commit securities fraud contrary to 15 U.S.C. §§ 77q(a) and 77x (Securities Act of 1933) and 15 U.S.C. §§ 78j(b) (section 10(b)) and 78ff (Securities Exchange Act of 1934) and 17 C.F.R. § 240.10b-5 (Rule 10b-5) in violation of 18 U.S.C. § 371 (Count I); and, with execution of schemes to defraud in connection with transactions in three different securities (Counts II through IV). Wynn was charged in nine additional wire fraud counts.

After a six-month trial, the jury returned guilty verdicts against Wynn and Haddy on all charges.[4] Post-trial motions were denied.[5] Haddy was sentenced to 27 months'

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4. The jury found Nandino not guilty on Count IV but could not reach a verdict on the remaining counts. Constantinou was acquitted of all charges against him. Frankel pled guilty prior to trial.

Other coconspirators, Barry Davis, Ronald Martini, John LaSala, Allen Weinstein, Ronald Spencer, Douglas Selander, Frank Grillo, and John Marsala, entered cooperating plea agreements, prior to trial, to informations stemming from the same investigation.

5. Prior to sentencing, Wynn requested a competency hearing nunc pro tunc, alleging that he had suffered from a mental disability which had prevented him from fully participating in his trial. At the government's request, the district court appointed a psychiatrist to examine Wynn. The district court then conducted a competency hearing with testimony from the court-appointed psychiatrist and from the psychiatrist who had

imprisonment and ordered to pay a special assessment of $200. Wynn was sentenced to 52 months' imprisonment, followed by three years of supervised release. A $50,000 fine was also imposed on Wynn.

II.

We first address whether Counts II, III and IV of the indictment, charging manipulation of the stocks of each of the three public shell companies, were duplicitous. This is a legal question requiring plenary review. *United States v. Bryan*, 868 F.2d 1032, 1037 (9th Cir. 1989).

The indictment charged Wynn and Haddy with engaging in a fraudulent scheme to design to manipulate the price of Vista (Count II), Castleton (Count III) and Bellatrix (Count IV) securities.[6] Wynn and Haddy contend that each individual transaction relating to the individual securities should have been charged in a separate count. Charging an

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treated Wynn during trial. After the hearing and argument, the district court denied Wynn's motion to be declared incompetent nunc pro tunc. The court also denied accompanying motions for a new trial based on Wynn's alleged incompetence and additional post-trial motions brought by both defendants.

6. The relevant portion of Count II reads:

> From at least as early as in or about January 1988, to at least as late as in or about December, 1988, in the District of New Jersey and elsewhere, the defendants Eric Wynn . . . Brad Haddy . . . and others . . . knowingly and willfully employed a scheme to defraud in connection with the purchase and sale of Vista Securities, through the use of means and instrumentalities of interstate commerce and of the mails, in that they took actions designed to manipulate the price of Vista Securities, all as set forth in Count I of this indictment.
>
> In violation of Title 15, United States Code, Sections 78j(b) and 78ff, Title 18, United States Code, Section 2, and Title 17, Code of Federal Regulations, Section 240.10b-5.

Counts III and IV were identical except in the identification of the particular security and dates involved. The stock manipulation related to Castleton (Count III) and Bellatrix (Count IV) occurred between June and December of 1988.

overall scheme, they argue, renders the indictment faulty because of its duplicity.

Duplicity is the improper joining of distinct and separate offenses in a single count. *United States v. Starks*, 515 F.2d 112, 116 (3d Cir. 1975). Duplicitous counts may conceal the specific charges, prevent the jury from deciding guilt or innocence with respect to a particular offense, exploit the risk of prejudicial, evidentiary rulings, *id.* at 116-17, or endanger fair sentencing. *United States v. Shorter*, 809 F.2d 54, 58 n.1 (D.C. Cir. 1987).

We must ascertain the allowable unit of prosection to decide if the counts of the indictment properly charge a violation of the pertinent statute. *United States v. Amick*, 439 F.2d 351, 359 (7th Cir. 1971), *see also United States v. Pollen*, 978 F.2d 78, 85 (3d Cir. 1992) (multiplicity[7] case holding that indictment must follow statute creating offense). Congressional intent dictates the proper unit of prosecution. *United States v. Cooper*, 966 F.2d 936, 942 (5th Cir. 1992).

The starting point in determining the intent of Congress is, of course, the language of the statute. 15 U.S.C. § 78j(b), commonly known as section 10(b), by its title, proscribes employment of manipulative deceptive devices in connection with securities transactions. The section reads:

> **§ 78j. Manipulative and deceptive devices.**
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> ***
>
> (b) to use or employ, in any connection with the purchase or sale of any security registered on the national securities exchange or any security not so

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7. Indictments charging a single offense in different counts are multiplicitous. Multiplicity may result in multiple sentences for a single offense in violation of double jeopardy, or otherwise prejudice the defendant. *United States v. Cooper*, 966 F.2d 936, 942 n.9 (5th Cir. 1992).

> registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b).

Under the authority of this section, the SEC promulgated Rule 10b-5 to execute enforcement of section 10(b). The regulation makes it unlawful for any person, in connection with the purchase or sale of security, to (1) employ a device, scheme or artifice to defraud; (2) make any false statement of material fact; or, (3) engage in any act, practice or course of business that operates as fraud or deceit upon any person. The clear wording of the statute and the rule thus emphasize the use of manipulative devices in describing the offense. The phrase "in connection with the purchase or sale of securities" positions the illegal activity within the framework of the Securities Exchange Act; it does not describe the prohibited conduct.

The Supreme Court has interpreted section 10(b) and Rule 10b-5 expansively in accordance with its view of Congress' intent in enacting the 1934 Act as a vehicle to minimize fraud in securities trading. As the Court stated in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972), "These proscriptions, by statute and rule, are broad and, . . . obviously meant to be inclusive." The legislation is construed " 'flexibly to effectuate its remedial purpose,' " *id.* (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)), not "technically and restrictively." *Id.*

The particular counts of the indictment before us track the statutory and regulatory language. They describe the manipulative implementation of a securities trading scheme, the precise activity described in the statute and the implementing rule as illegal. Here, the device was a four-part scheme in which the buying and selling of securities was a segment. Without the boxing, the generation of demand, the contrived rise of the price and the sale at the profit, however, any particular transaction might not be unlawful. Rather, the purchase or sale was intended to further the manipulation of the stock price.

We thus conclude that the individual purchase or sale was not the appropriate unit of prosecution here; these retail events were only a step in the advancement of the scheme as a whole. On the facts here, each count properly charged a manipulation of the securities of each of the three separate companies — each involving a discrete scheme.

In resolving this issue, we decline to dictate an inflexible rule regarding the allowable unit of prosecution in a securities fraud case. The Federal Rules of Criminal Procedure require that an indictment be a "plain, concise, and definite written statement of the essential facts constituting the offense charged." Fed. R. Crim. P. 7(c)(1). Here, the offenses charged were schemes designed to manipulate the prices of securities. It may be that other violations of the securities laws would lend themselves to a differently enumerated indictment. For example, in a multiplicity case, *United States v. Langford*, 946 F.2d 798 (11th Cir. 1991), the issue was whether the use of multiple mailings in furtherance of a conspiracy to commit securities fraud in violation of section 10(b) and Rule 10b-5 could form the basis of separate counts of an indictment. The Court of Appeals for the Eleventh Circuit decided that it could not. In so concluding, the Eleventh Circuit recognized that the allowable unit of prosecution under section 10(b) is the use of a manipulative device or contrivance. *Id.* at 803. The court decided, however, that the overall scheme need not be charged in a single count. Instead, any false statement in connection with a discrete sale can be considered an appropriate unit of prosecution. *Id. Langford* does not mandate, however, that each sale *must* form the basis of a count of the indictment. Rather, it clarified that in addition to the allowable prosecution of a scheme to defraud, it can be something less.

Finally, on this issue, we observe that even if the indictments were duplicitous, the error would be harmless. None of the concerns of duplicity have been implicated. There is no allegation here that the integrity of the prosecution was compromised by the particular structure of the indictment. Therefore, we conclude that counts II, III and IV of the indictment, each involving a course of activity

yet a single scheme, properly charged Haddy and Wynn with violations of the securities laws.

III.

Reliance Requirement

Haddy and Wynn also argue that their convictions should be reversed because the government did not prove that investors actually relied upon fraudulent and manipulative practices in purchasing or selling the subject securities. The specific question is whether reliance is an element of the crime of stock manipulation, proof of which is essential to conviction. We hold that no such statutory requirement exists.

The federal securities law were enacted largely in response to the stock market crash of 1929. Congress recognized the need for investors to be protected against fraud, and that if regulatory control in the securities industry had been in place, the turbulence created by the crash may have, at least, been abated. S. Rep. No. 1445, 73d Cong., 2d Sess. 81 (1934). Thus, in the interest of preventing practices that destabilized the securities market, the Securities Act of 1933 and the Securities Exchange Act of 1934 established systems requiring full disclosure of material information by companies transacting in securities. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976). The Securities and Exchange Commission then promulgated Rule 10b-5 in 1942 to achieve the remedial purposes of the 1934 Act. As we mentioned above, the Supreme Court has opined that these laws should be flexibly applied. *Affiliated Ute*, 406 U.S. at 151.

We again look first to the statutory language to define the contours of the offense. Neither the statute nor the rule includes a reliance requirement. Instead, both section 10(b) and Rule 10b-5 prohibit the employment of manipulative and deceptive devices in connection with the purchase or sale of securities.

Section 10(b)'s omission of reference to a particular victim is compelling evidence that investor reliance is not

required for a securities fraud conviction. The language does not proscribe deception on a purchaser or seller of a security; instead it speaks to deceptive devices employed "in connection with the purchase or sale of any security." *United States v. O'Hagan*, 117 S. Ct. 2199, 2210 (1997).

Rule 10b-5 also prohibits deceptive *devices* "as necessary or appropriate in the public interest or for the protection of investors." Under this regulation, the SEC is authorized to prohibit deceptive acts that it concludes would have deleterious effect on the integrity of the securities market and on investor confidence. *See* 15 U.S.C. § 78b (purpose of Exchange Act is "to insure the maintenance of fair and honest markets"). This clear language obviates the necessity of identification of a specific victim who acted upon the deception.

In *United States v. Naftalin*, 441 U.S. 768 (1979), the Supreme Court rejected the contention that section 17a of the Securities Act of 1933, which prohibits any device, scheme or artifice to defraud in the offer or sale of any securities, requires that the deception be perpetrated on the individual purchasing the stock. In *Naftalin*, an investor was prosecuted for falsely representing to a broker that he owned certain stock. The brokers who were deceived suffered losses, but not those investors who actually purchased the shares. Naftalin argued that the 1933 Act's prohibition against fraud "in" the offer of the sale of securities was narrower than section 10(b)'s proscription against deception "in connection with" the purchase or sale and, accordingly did not encompass deception directed at brokers. The Court expressed doubt that the phrases of the two Acts had different scopes; but, even assuming a narrower reach of the 1933 Act, the Court rejected the argument that it was limited to fraud on investors. *Id.* at 773 n.4. The Court interpreted section 17a as requiring only that the fraud occur "in" an offer or sale of securities. *Id.* at 772-73. We read *Naftalin*, then, as teaching that if fraud "in" a securities transaction, as prohibited by the 1933 Act, does not require fraud on an investor, then deception "in connection with" a securities transaction per the 1934 Act does not have such a requirement.

Appendix A

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) concerned a private right of action under the securities laws, but is nonetheless instructive on the question of reliance by identifiable victims in a criminal case. In *Blue Chips*, the Court limited the class of persons who may bring an action under section 10(b) and Rule 10b-5 to those who would actually purchase or sell securities. The Court imposed the purchase or sell requirement for *standing* purposes – recognizing the danger of litigation by investors who did not make an actual purchase but who might later claim that they would have but for the alleged deceptive conduct. *Id.* at 747. Significantly, in *Naftalin*, the Court made clear that the purchaser-seller standing rule of *Blue Chips* is "inapplicable" to a criminal prosecution. 441 U.S. at 774 n.6.

The statutory term "manipulation" also detracts from a theory that specific investor reliance is required. In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 476-77 (1977), the Supreme Court offered that manipulation is virtually a term of art in securities law and refers to conduct artificially affecting market activity in order to mislead investors. The activity described here falls within the confines of this description. Wynn and Haddy devised a scheme by which the prices of certain securities did not reflect market trends, but rather, were induced by their contrivances affecting the price of the stock. The allocation of the stock, the controlled dissemination of insider information, and the offering of bribes had the impact of artificially influencing market activity. A particular investor's reliance on the representations is the anticipated response, but it is not an element of the offense.

The issue of investor reliance was recently decided by the Supreme Court in *O'Hagan* in the context of a misappropriation case. Under the misappropriation theory, securities fraud is committed when a person, in connection with a securities transaction, misappropriates confidential information in breach of a duty to the source of the information. 117 S.Ct. at 2207.

The *O'Hagan* defendant was a partner of a law firm which had been retained as local counsel by a company that was planning to acquire a second company. During the

preparation stages of the acquisition, O'Hagan purchased call options for the target company stock, as well as shares in the target company. Following the public announcement of the tender offer, the lawyer exercised his call options, liquidated his position and realized a profit in excess of four million dollars. The Supreme Court upheld O'Hagan's conviction under section 10(b) and Rule 10b-5 on a misappropriation theory of securities fraud. The Court noted that the theory comports with 10(b)'s language, which requires deception "in connection with the purchase or sale of any security," *not* deception of an individual purchaser or seller. *Id.* At 2210. Thus, although O'Hagan differs by virtue of the theory the prosecution pursued, it is strong affirmation of the language of *Nafatlin* and *Blue Chips* that convictions under the securities laws do not require identification of or reliance by a particular victim. What distinguishes misappropriation from manipulation is the party to whom disclosure was not afforded. With manipulation, it is the investors who are deceived. With misappropriation, it is the source of the information, in most instances, the corporation involved. This distinction does not change the fact that the integrity of the free market has been compromised.

We therefore conclude that reliance on the deceptive practice by an identifiable victim participating in a securities transaction is not required for conviction in the type of stock manipulation case before us.[8]

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8. *United States v. Russo*, 74 F.3d 1383 (2d Cir. 1996), is not to the contrary. In *Russo*, the defendants were convicted in a stock manipulation scheme which involved short sales of high value stocks by a market maker to generate false credits in an account with a clearing broker. The district court instructed the jury that in order to find the defendants guilty of section 10(b) and Rule 10b-5 securities fraud, it must find that the clearing broker was deceived. The Court of Appeals for the Second Circuit held that the instruction was proper because "it fairly apprised the jury of the essence of the defense theory...." *Id.* at 1393. The case did not hold, nor was it an issue, that reliance is a required element in a securities fraud case.

Appendix A

IV.

Conclusion

For the reasons above, we will affirm the judgments in these criminal cases.

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX B — STATUTORY RULE AND CONSTITUTIONAL PROVISION INVOLVED

17 C.F.R. § 240.10b-5

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

AMENDMENT VI — JURY TRIAL FOR CRIMES AND PROCEDURAL RIGHTS

In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defense.